THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

17 July 2009

Our ref: ICAEW Rep 74/09

Your ref:

Sir David Tweedie
The International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

By email: commentletters@iasb.org

Dear David

LEASES

The Institute of Chartered Accountants in England and Wales pleased to respond to your request for comments on the Discussion Paper DP/2009/1 *Leases - Preliminary Views*, published by the International Accounting Standards Board in March 2009.

Please contact me if you would like to discuss any of the points raised in the attached response.

Yours sincerely

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THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

ICAEW Representation

ICAEW REP 74/09

LEASES

Memorandum of comment submitted in July 2009 by The Institute of Chartered Accountants in England and Wales, in response to the Discussion Paper DP/2009/1 *Leases - Preliminary Views*, published by the International Accounting Standards Board in March 2009.

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INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the Institute) welcomes the opportunity to comment on the Discussion Paper DP/2009/1 *Leases - Preliminary Views*, published by the International Accounting Standards Board in March 2009.

WHO WE ARE

2. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 132,000 members in more than 165 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 775,000 members worldwide.

3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures these skills are constantly developed, recognised and valued.

4. Our members occupy a wide range of roles throughout the economy. This response was developed by the Financial Reporting Committee of the Institute, which includes preparers, analysts, standard-setters and academics as well as senior members of accounting firms and public sector bodies.

MAJOR ISSUES

Welcome for the Discussion Paper

5. We welcome publication of this Discussion Paper. We agree that lessee accounting requires attention, although it is not particularly urgent at present in the context of the Board's current workload and priorities. In particular, we question the decision - albeit an understandable one - to defer consideration of lessor accounting. We believe it is difficult to be confident of the underlying principles of lease accounting when they are considered from only one perspective. We believe strongly that lessee and lessor accounting should be considered together as this project progresses. Furthermore, it is clear that some of the concepts relevant for lease accounting are being considered as part of other projects (such as revenue and derecognition). We encourage the boards to seek consistency in their approaches to all of these projects.

Scope

6. We believe that the scope of a new standard should be based on IAS 17 rather than FAS 13. In addition:

- The existing exemptions in IAS 17 need to be considered carefully. In principle, we believe that they should be removed unless a strong new case can be made for retention. However, we recognise the practical consequences of bringing items such as licences within the scope of a new leasing standard.

- Executory contracts and service contracts should be excluded from the scope of the standard, because they do not confer the right to use an asset.

- Non-core asset leases and short-term leases should not be excluded from the scope of the proposed standard.

(See paragraphs 17 - 22 below.)

The asset/liability model

7. We accept the board's analysis of assets and liabilities arising under simple leases for the purposes of the proposed standard. However, although the asset may exist for more complex leases on the basis of control, we question whether the liability is consistent with the definition in the Framework. (See paragraph 23 below.)

8. We agree with the right-of-use model. The current distinction between operating and finance leases is arbitrary and vulnerable to structuring: we welcome the boards' proposal to abandon it. (See paragraph 24 below)

Initial measurement

9. We agree that the present value of the lease payments should be discounted using the lessee's incremental borrowing rate, although we accept that this may sometimes difficult to determine. We do not believe that the rate should be subsequently reassessed. (See paragraphs 26 - 27 below)

10. We agree that the right-of-use asset should initially be measured at cost. (See paragraph 28 below.)

Leases with options

11. We do not believe that the lease term should be recognised on the basis of the most likely term. We would recognise only the minimum lease term, unless the terms of an extension option or other business or economic factors make it inevitable that a lease extension option will be exercised, in which case the lease term should reflect this obligation. (See paragraphs 34 - 36 below.)

Contingent rentals

12. The lessee's obligation to pay rentals should include amounts payable under contingent rental arrangements. The obligation should be measured on the basis of management's best estimate of the eventual cash flows associated with the lease, which will not necessarily be driven by an analysis of probabilities assigned to various outcomes. (See paragraphs 41 and 42 below.)

13. On balance we support recognising any change in the liability in profit or loss, with the amount disclosed separately. This will be a practical approach for most, particularly small, leases. And, conceptually, we cannot see that using an asset more means that the right-of-use asset has been enhanced in some way. (See paragraph 45 below.)

Lessor accounting

14. As noted above, we are disappointed that the boards have not given greater consideration to lessor accounting in this Discussion Paper. Failing to address lessor accounting makes it difficult to dispense fully with the distinction between finance and operating leases (which we support). And, regardless of other considerations, we believe it will be necessary to address intermediate leases at exposure draft stage. As the boards have not reached preliminary conclusions on lessor accounting, our answers to the specific questions are only provisional. We expect to be given opportunity to provide comment on the boards' proposals for lessor accounting at the appropriate time.

Service contracts

15. As noted above, we are content for service contracts to be excluded from the scope of the proposed standard. However, we believe that the proposals will bring additional pressure to bear on the already difficult-to-determine boundary between leases and service contracts. There is a certain amount of guidance in IFRIC 4 *Determining Whether an Arrangement Contains a Lease*, but this is not comprehensive and will need to be thoroughly re-examined for inclusion in an exposure draft.

SMEs

16. Abandoning the distinction between operating and finance leases will have a potentially disproportionate effect on SMEs, which, materiality constraints notwithstanding, will in principle be required to recognise relatively minor assets. We urge the boards to develop a simplified model for SMEs that recognises their limited resources and the realistic needs of users. Some of the suggestions we make in this comment letter regarding lease term (question 13) and measurement of lease obligations (question 17) would go a long way towards achieving this. Obviously this will be an issue when any new standard affects the updating of the IFRS for SMEs.

ANSWERS TO SPECIFIC QUESTIONS

Chapter 2: Scope of lease accounting standard

Question 1

The boards tentatively decided to base the scope of the proposed new lease accounting standard on the scope of the existing lease accounting standards.

Do you agree with this proposed approach?

If you disagree with the proposed approach, please describe how you would define the scope of the proposed new standard.

17. We agree that the scope of a new standard should be based on the scope of existing lease accounting standards. However, the scope of those standards is different in the areas set out in Appendix B to the Discussion Paper. The boards will need to reconcile these differences prior to issuing any new leasing standard. Whilst our focus is on seeing the IASB issue a high quality standard for accounting for leases, we would consider it disappointing if the IASB and FASB were to issue equivalent standards that are applied to different items.

18. On balance, we believe that the scope of a new standard should be based on IAS 17, which includes within its scope certain intangible assets, rather than FAS 13. From this starting point, the existing exemptions in IAS 17 need to be considered carefully. Whilst it is difficult to make a conceptual case for excluding, for example, intangible assets such as licenses and patents from the scope of a new standard (the existing exclusions from the scope of IAS 17 lack any justification, conceptual or otherwise), the consequences of bringing such items within the scope of a new leasing standard could be significant in certain industries (for example, pharmaceuticals and software).

19. Notwithstanding our comment in the previous paragraph regarding scope exemptions, we believe that investment property should continue to be scoped out of the leasing standard. We believe that a fair value measurement basis for investment property provides better information for users and we would not support removal of this option. However, under IAS 40 entities currently have a choice regarding whether to measure investment properties at fair value. We encourage the boards to explore an amendment to IAS 40 which would remove the 'cost' option and replace it with a requirement to account for investment property in accordance with the leasing standard if fair value measurement is not selected.

20. We agree that it is appropriate to exclude executory contracts and service contracts from the scope of the standard, because they do not confer the right to use an asset. However, we believe the boards need to establish clearer conceptual grounds for not recognising a liability and an asset in connection with executory and service contracts when they seem to establish similar rights and obligations to those created by a lease.

21. The standard will need to include clear guidance to address the potential problem of arrangements being structured as service contracts. Currently, the distinction between an operating lease and a service contract is not regarded as critical as the basic accounting is the same. Under the proposed model, the distinction will become much more important. The practical impact of incorporating IFRIC 4's guidance within a new leasing standard should be examined before the provisions of those interpretations are incorporated into a revised standard.

Question 2

Should the proposed new standard exclude non-core asset leases or short-term leases? Please explain why.

Please explain how you would define those leases to be excluded from the scope of the proposed new standard.

22. We do not believe that the proposed new standard should exclude non-core asset leases or short-term leases. However, as noted by the boards, we believe that sometimes the distinction between accounting for short-term leases and leases of non-core assets in accordance with the proposals in the discussion paper and accounting for them as period costs may be immaterial to a lessee. In those circumstances we believe it will be sufficient to exclude such leases under existing principles. On the other hand, material items, either individually or in aggregate, will be of interest to users and should not be excluded from the scope of the standard.

Chapter 3: Approach to lessee accounting

Question 3

Do you agree with the boards' analysis of the rights and obligations, and assets and liabilities arising in a simple lease contract? If you disagree, please explain why.

23. We are content to accept the analysis for the purpose of establishing a pragmatic approach to lessee accounting. However, we note the boards' 'tentative' conclusions that the rights and obligations meet the definitions of an asset and a liability. Whilst we accept the analysis provided in respect of a simple lease, we are not convinced that the definitions are met when considering more complex lease arrangements for the reasons set out in our response to question 13. The boards might do better to acknowledge that they are adopting a simplified asset/liability model for this specific purpose, and reserve the right to readdress the issue at a later date in another context.

Question 4

The boards tentatively decided to adopt an approach to lessee accounting that would require the lessee to recognise:

(a) an asset representing its right to use the leased item for the lease term (the right-of-use asset)

(b) a liability for its obligation to pay rentals.

Appendix C describes some possible accounting approaches that were rejected by the boards.

Do you support the proposed approach?

If you support an alternative approach, please describe the approach and explain why you support it.

24. We support the proposed approach for a simple lease for the reasons set out in chapter 3 of the Discussion Paper. We believe that the 'whole asset approach' overstates the balance sheet and is not consistent with the conceptual definitions of an asset or liability. We are aware of some investor concern about this, arguing that the whole asset approach is the best way of approximating to a 'buy' decision, but believe that this concern is better addressed through disclosure.

Question 5

The boards tentatively decided not to adopt a components approach to lease contracts. Instead, the boards tentatively decided to adopt an approach whereby the lessee recognises:

(a) a single right-of-use asset that includes rights acquired under options

(b) a single obligation to pay rentals that includes obligations arising under contingent rental arrangements and residual value guarantees.

Do you support this proposed approach? If not, why?

25. We support not adopting a component approach, which would be too complex in practice. In addition to the reasons set out in the Discussion Paper, we believe that users view a lease contract as a single unit of account. Therefore, we believe that a single set of principles should be applied to a lease contract in its entirety, rather than separately to the various rights and obligations that may co-exist in a single contract.

Chapter 4: Initial measurement

Question 6

Do you agree with the boards' tentative decision to measure the lessee's obligation to pay rentals at the present value of the lease payments discounted using the lessee's incremental borrowing rate?

If you disagree, please explain why and describe how you would initially measure the lessee's obligation to pay rentals.

26. We agree, for the reasons set out in the Discussion Paper. While the incremental borrowing rate (IBR) may sometimes be difficult to ascertain with any precision, we believe that in most cases it is a more accessible measure than the interest rate implicit in the lease. Furthermore, it is consistent with the basis for measuring financial liabilities measured at amortised cost and has the advantage of being the rate relevant to the lessee rather than the lessor. We accept that the lessee's IBR ignores the lessor's asset risk and tax breaks, but we believe that the IBR's advantages of relevance to the lessee, greater accessibility and usefulness make it the best choice on both theoretical and practical grounds. The IBR should be disclosed for transparency and ease of comparison between entities and over time.

27. Some have argued that the standard should require that the lessee's IBR be used only when the lessee is unable to estimate the lessor's implicit rate. We would not support this approach. Not only does it add complexity to the standard, we believe that in many cases where the lessee is able to estimate the implicit rate this would form a valuable basis for an estimate of the IBR. Hence, we believe that it is more practical for preparers to apply one rate (vs having a choice), while a single rate convention better supports comparability.

Question 7

Do you agree with the boards' tentative decision to initially measure the lessee's right-of-use asset at cost?

If you disagree, please explain why and describe how you would initially measure the lessee's right-of-use asset.

28. We agree. We believe that accounting requirements for right-of-use assets should be similar to other non-financial assets. In that context, the same rules for impairment and directly attributable costs of acquisition should apply.

Chapter 5: Subsequent measurement

Question 8

The boards tentatively decided to adopt an amortised cost-based approach to subsequent measurement of both the obligation to pay rentals and the right-of-use asset.

Do you agree with this proposed approach?

If you disagree with the boards' proposed approach, please describe the approach to subsequent measurement you would favour and why.

29. We agree. It is important that the accounting for lease liabilities and debt liabilities are aligned as much as possible. Similarly, consistent with our response to question 7 above, the accounting for leased and owned assets should be the same.

30. We recognise that an implication of this approach is that the carrying amount of a right-of-use asset and its related lease liability will be different other than at initial recognition. We can understand why some board members support a linked approach to subsequent measurement in order to alleviate this perceived problem. However, we do not see sufficient justification for adopting a different subsequent measurement model for lease assets and liabilities compared to owned assets and debt. Nevertheless, the boards will need to consider the mismatch as they address issues surrounding first-time adoption of a new leasing standard.

Question 9

Should a new lease accounting standard permit a lessee to elect to measure its obligation to pay rentals at fair value? Please explain your reasons.

31. Although it would be difficult to apply, we would not object to a fair value option that encompasses the same criteria as IAS 39. In practice, we believe that it would be rare for a lessee to wish to measure a lease liability at fair value. However, where lease contracts contain embedded derivatives that would otherwise need to be separated, we believe it would be inappropriate to prohibit fair value measurement whilst permitting such measurement for an equivalent debt instrument.

Question 10

Should the lessee be required to revise its obligation to pay rentals to reflect changes in its incremental borrowing rate? Please explain your reasons.

If the boards decide to require the obligation to pay rentals to be revised for changes in the incremental borrowing rate, should revision be made at each reporting date or only when there is a change in the estimated cash flows?

Please explain your reasons.

32. We support the FASB's view that the IBR should not be reassessed. If the boards have concluded that the lease liability should be measured on an amortised cost basis (a conclusion that we support), that basis should be consistent with the amortised cost basis required by IAS 39, which does not require reassessment. However, given the current rapid developments on the IASB's financial instruments

project, the boards should ensure that the projects are consistent with regard to reassessment of the discount rate.

Question 11

In developing their preliminary views the boards decided to specify the required accounting for the obligation to pay rentals. An alternative approach would have been for the boards to require lessees to account for the obligation to pay rentals in accordance with existing guidance for financial liabilities.

Do you agree with the proposed approach taken by the boards?

If you disagree, please explain why.

33. We agree. IAS 39 would not be appropriate for lease obligations, because of general complexity and, for example, the fact that it is more componentised. Furthermore, the unique nature of lease contracts, involving both an obligation to make payments and a non-financial right-of-use asset, means that a separate accounting solution is required.

Question 12

Some board members think that for some leases the decrease in value of the right-of-use asset should be described as rental expense rather than amortisation or depreciation in the income statement.

Would you support this approach? If so, for which leases? Please explain your reasons.

34. We do not support accounting for the decrease in value of the right-of-use asset as a rental. We cannot see how this fits the boards' proposed asset model and, consistent with our response to question 7, we believe it is important for a right-of-use asset to be treated in a manner similar to other owned assets. We believe that the concerns of those board members who think that the decrease in value of the right-of-use asset should be described as rental should be addressed through disclosure rather than inconsistent presentation in the income statement.

Chapter 6: Leases with options

Question 13

The boards tentatively decided that the lessee should recognise an obligation to pay rentals for a specified lease term, ie in a 10-year lease with an option to extend for five years, the lessee must decide whether its liability is an obligation to pay 10 or 15 years of rentals. The boards tentatively decided that the lease term should be the most likely lease term.

Do you support the proposed approach?

If you disagree with the proposed approach, please describe what alternative approach you would support and why.

35. We do not support the proposed approach. We agree that option pricing should not be applied and that a simpler approach is required. We are not attracted to any of the solutions considered by the boards. We suggest that the liability should be limited

to the minimum lease term, with the option to extend the lease only recognised when it is highly likely that the lease will be extended. Otherwise, for the reasons set out in paragraph 6.37 of the Discussion Paper, there is no liability because the lessee does not have to pay the rentals in the extension period.

36. Currently, IAS 17 takes a lease extension option into account where it is 'reasonably certain' that the option will be exercised. We would support a similar threshold, based on contractual, business or other economic factors that make it inevitable that a lease extension option will be exercised. We would support this approach with disclosure of the existence of extension options and the potential payments that may be made thereunder.

37. We believe such an approach has the advantages of conforming with the Framework definition of a liability, avoiding the spurious outcomes resulting from estimates and calculations, and, with disclosures, providing users with the most useful information.

Question 14

The boards tentatively decided to require reassessment of the lease term at each reporting date on the basis of any new facts or circumstances. Changes in the obligation to pay rentals arising from a reassessment of the lease term should be recognised as an adjustment to the carrying amount of the right-of-use asset.

Do you support the proposed approach?

If you disagree with the proposed approach, please describe what alternative approach you would support and why.

Would requiring reassessment of the lease term provide users of financial statements with more relevant information? Please explain why.

38. We agree that extensions of or reductions in the lease terms should be dealt with as an adjustment to the right-of-use asset. However, consistent with our response to question 13 above, we believe that reassessment of the lease term should only be necessary when an option to extend or terminate a lease is exercised or new evidence indicates that it is highly likely that such an option will be exercised.

Question 15

The boards tentatively concluded that purchase options should be accounted for in the same way as options to extend or terminate the lease.

Do you agree with the proposed approach?

If you disagree with the proposed approach, please describe what alternative approach you would support and why.

39. We agree that purchase options should be accounted for in the same way as options to extend a lease, whatever the approach adopted.

Chapter 7: Contingent rentals and residual value guarantees

Contingent rentals

Question 16

The boards propose that the lessee's obligation to pay rentals should include amounts payable under contingent rental arrangements.

Do you support the proposed approach?

If you disagree with the proposed approach, what alternative approach would you recommend and why?

40. We agree that the lessee's obligation to pay rentals should include amounts payable under contingent rental arrangements.

Question 17

The IASB tentatively decided that the measurement of the lessee's obligation to pay rentals should include a probability-weighted estimate of contingent rentals payable. The FASB tentatively decided that a lessee should measure contingent rentals on the basis of the most likely rental payment. A lessee would determine the most likely amount by considering the range of possible outcomes. However, this measure would not necessarily equal the probability-weighted sum of the possible outcomes.

Which of these approaches to measuring the lessee's obligation to pay rentals do you support? Please explain your reasons.

41. We believe that both approaches proposed by the boards are flawed in that they seek to apply an analysis of probabilities that, in reality, will be inestimable. They imply an accuracy that is entirely spurious.

42. We support measurement of lease obligations based on management's best estimate of the eventual cash flows associated with the lease. We acknowledge that sometimes this may be achieved by assigning probabilities to alternative outcomes, but do not believe that such an approach should be mandated. We believe that all relevant facts and circumstances (both quantitative and qualitative) should be taken into account in order to derive a best estimate of the amounts the lessee expects to pay. We would expect such an estimate to be consistent with management's budgets and forecasts insofar as they exist.

Question 18

The FASB tentatively decided that if lease rentals are contingent on changes in an index or rate, such as the consumer price index or the prime interest rate, the lessee should measure the obligation to pay rentals using the index or rate existing at the inception of the lease.

Do you support the proposed approach? Please explain your reasons.

43. We do not support the FASB's proposed approach. Consistent with our response to question 17 above, we believe that lease obligations should be measured on the basis of the amounts that the lessee expects to pay. Hence, expected changes in

indices would be included in the determination of those amounts so the issue contemplated by the FASB would not arise.

Question 19

The boards tentatively decided to require remeasurement of the lessee's obligation to pay rentals for changes in estimated contingent rental payments.

Do you support the proposed approach? If not, please explain why.

44. We agree, although consider that the 'best estimate' should be reassessed only when there is a substantive change or new evidence, rather than at each period end.

Question 20

The boards discussed two possible approaches to recognising all changes in the lessee's obligation to pay rentals arising from changes in estimated contingent rental payments:

(a) recognise any change in the liability in profit or loss

(b) recognise any change in the liability as an adjustment to the carrying amount of the right-of-use asset.

Which of these two approaches do you support? Please explain your reasons.

If you support neither approach, please describe any alternative approach you would prefer and why.

45. On balance we support recognising any change in the liability in profit or loss, with the amount disclosed separately. This will be a practical approach for most, particularly small, leases. And, conceptually, we cannot see that using an asset more means that the right-of-use asset has been enhanced in some way.

Residual value guarantees

Question 21

The boards tentatively decided that the recognition and measurement requirements for contingent rentals and residual value guarantees should be the same. In particular, the boards tentatively decided not to require residual value guarantees to be separated from the lease contract and accounted for as derivatives. Do you agree with the proposed approach? If not, what alternative approach would you recommend and why?

46. We agree. Contingent rentals and residual value guarantees are too similar to be accounted for differently based on their labels.

Chapter 8: Presentation

Question 22

Should the lessee's obligation to pay rentals be presented separately in the statement of financial position? Please explain your reasons.

What additional information would separate presentation provide?

47. We do not believe that the lessee's obligation to pay rentals should be presented separately in the statement of financial position. Given the boards' objective for lease liabilities to be treated similarly to secured debt finance, we believe that separate analysis in the notes is sufficient.

48. If the final standard requires lease extension options to be accounted for in the manner proposed in the Discussion Paper, this will mean that the lease liability will include some payments that the lessee is obligated to make and some that it is not. Notwithstanding our response to question 13 above, we believe that there should be clear disclosure of these amounts. In addition, users may be interested to know what the liability would be if all leases were expected to last until their maximum or minimum lease terms as this would enable users to understand the range of potential outcomes. We believe equity investors will tend to focus on the maximum lease term as being closer to the ownership model ensuring comparability of similar businesses, whilst many fixed income investors will focus on the minimum lease term to understand the unavoidable liability in the event of financial difficulty.

Question 23

This chapter describes three approaches to presentation of the right-of-use asset in the statement of financial position.

How should the right-of-use asset be presented in the statement of financial position?

Please explain your reasons.

What additional disclosures (if any) do you think are necessary under each of the approaches?

49. We agree that the right of use asset should be presented according to the nature of the underlying leased item. Leased and owned assets should be separately disclosed in the notes.

Chapter 9: Other lessee issues

Question 24

Are there any lessee issues not described in this Discussion Paper that should be addressed in this project? Please describe those issues.

50. There are a number of issues that the boards have not yet discussed. We are aware that there has been discussion of some of these since the Discussion Paper was issued. We expect to be given opportunity to comment on any proposals before a standard is finalised. Issues that need to be considered, in addition to those listed in chapter 9 of the Discussion Paper, include the following:

- Lease incentives. The existing guidance in SIC 15 concerns operating leases and so will cease to be relevant under the boards' proposed model. While incentives in the form of a reduced rental could be reflected in the measurement of the right-of-use asset and lease obligation, other incentives (such as leasehold improvements or settlement of pre-existing lease commitments) would need to be addressed. Similarly, the boards should consider the corollary where a new tenant makes payments to an existing tenant on entering into a lease ('key money').

- Lease modifications. Lease modifications should be accounted for consistently with other debt modifications. That is, the right-of-use asset should not be adjusted unless there is a substantive change in the lessee's right to use the asset.

- Transition. As noted in our response to question 8, the boards will need to consider carefully how a future leasing standard is introduced. Preparers will need time to address the potential changes to financial statement presentation and the impact on resultant metrics, including many that tie directly into debt covenants, capital requirements or compensation arrangements.

  Whilst the practical simplicity of recognising an equal asset and liability on first time adoption is appealing, there may be cases where the phasing of cash flows means that this approach could significantly over or understate the right of use asset.

Chapter 10: Lessor accounting

Question 25

Do you think that a lessor's right to receive rentals under a lease meets the definition of an asset? Please explain your reasons.

51. We agree that a lessor's right to receive rentals meets the definition of an asset for the same reasons as a lessee's obligation to make payments meets the definition of a liability.

Question 26

This chapter describes two possible approaches to lessor accounting under a right-of-use model: (a) derecognition of the leased item by the lessor or (b) recognition of a performance obligation by the lessor.

Which of these two approaches do you support? Please explain your reasons.

52. We support approach (a), derecognition of part of the leased asset by the lessor. We do not believe that grossing up the asset and liability will provide meaningful information to users. The approach we support is consistent with the boards' rationale in proposing a right-of-use model and rejecting an executory contract model, in that the lessor does not have a performance obligation.

53. We note that the boards have recently stated support for approach (b). Whilst this approach is consistent with recent proposals for derecognition of financial assets (which we also do not support), we believe that it will not result in meaningful information. However, should the boards persist with this thinking, we encourage them to explore the concept of linked presentation, which has existed in UK GAAP in FRS 5 *Reporting the substance of transactions* since 1994. Under linked presentation, in certain conditions, where finance is repaid only out of the proceeds generated by the item it finances, that finance is shown deducted from the gross amount of the item it finances on the face of the balance sheet within a single asset caption. Applying similar logic to leases, if the boards believe that a lessor has a

performance obligation, that obligation can only be satisfied by the lessor making the leased item available to the lessee. Linked presentation would result in the liability reflecting the performance obligation being deducted from the gross amount of leased item on the face of the balance sheet. We believe that such a presentation could give similar information to approach (a) whilst remaining loyal to the views the boards may have already formed in support of approach (b).

54. It is encouraging that the boards have made progress on lessor accounting since issuing the discussion paper. It is difficult to be confident of the underlying principles of lease accounting when they are considered from only one perspective (that is, the lessee's) and we believe strongly that lessee and lessor accounting should be considered together as this project progresses. Consistent with our response to question 24 above regarding lessees, we expect to be given opportunity to comment on any proposals for lessor accounting before a standard is finalised.

Question 27

Should the boards explore when it would be appropriate for a lessor to recognise income at the inception of the lease? Please explain your reasons.

55. Yes. Whilst we believe that the revenue recognition project should provide the framework for this matter, it is important that the boards acknowledge the importance for both projects. If the criteria for recognising revenue have been met, we can see no conceptual justification for not recognising revenue solely because of the lessor's nature or business model.

Question 28

Should accounting for investment properties be included within the scope of any proposed new standard on lessor accounting? Please explain your reasons.

56. For the reasons set out in our response to question 1, we believe that investment properties should not fall within the scope of a new standard on lessor accounting.

Question 29

Are there any lessor accounting issues not described in this Discussion Paper that the boards should consider? Please describe those issues.

57. See our response to question 24 regarding lessees.

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